BEFORE THE

PUBLIC UTILITIES COMMISSION

OF RHODE ISLAND

CITY OF NEWPORT	**)**	
UTILITIES DEPARTMENT,	**)**	**DOCKET NO. 3578**
WATER DIVISION	**)**	

DIRECT TESTIMONY

OF

THOMAS S. CATLIN

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

MARCH 2004

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 20904

TABLE OF CONTENTS

BEFORE THE

PUBLIC UTILITIES COMMISSION

OF RHODE ISLAND

CITY OF NEWPORT UTILITIES DEPARTMENT, WATER DIVISION	)))	DOCKET NO. 3578

Direct Testimony of Thomas S. Catlin

Introduction

Q. WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Thomas S. Catlin. I am a principal with Exeter Associates, Inc. Our offices are located at 5565 Sterrett Place, Suite 310, Columbia, Maryland 21044. Exeter is a firm of consulting economists specializing in issues pertaining to public utilities.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I hold a Master of Science Degree in Water Resources Engineering and Management from Arizona State University (1976). Major areas of study for this degree included pricing policy, economics, and management. I received my Bachelor of Science Degree in Physics and Math from the State University of New York at Stony Brook in 1974. I have also completed graduate courses in financial and management accounting.

Q. WOULD YOU PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE?

A. From August 1976 until June 1977, I was employed by Arthur Beard Engineers in Phoenix, Arizona, where, among other responsibilities, I conducted economic feasibility, financial and implementation analyses in conjunction with utility construction projects. I also served as project engineer for two utility valuation studies.

From June 1977 until September 1981, I was employed by Camp Dresser & McKee, Inc. Prior to transferring to the Management Consulting Division of CDM in April 1978, I was involved in both project administration and design. My project administration responsibilities included budget preparation and labor and cost monitoring and forecasting. As a member of CDM's Management Consulting Division, I performed cost of service, rate, and financial studies on approximately 15 municipal and private water, wastewater and storm drainage utilities. These projects included: determining total costs of service; developing capital asset and depreciation bases; preparing cost allocation studies; evaluating alternative rate structures and designing rates; preparing bill analyses; developing cost and revenue projections; and preparing rate filings and expert testimony.

In September 1981, I accepted a position as a utility rates analyst with Exeter Associates, Inc. I became a principal and vice-president of the firm in 1984. Since joining Exeter, I have continued to be involved in the analysis of the operations of public utilities, with particular emphasis on utility rate regulation. I have been extensively involved in the review and analysis of utility rate filings, as well as other types of proceedings before state and federal regulatory authorities. My work in utility rate filings has focused on revenue requirements issues, but has also addressed service cost and rate design matters. I have also been involved in analyzing affiliate relations, alternative regulatory mechanisms, and regulatory restructuring issues. This experience has involved electric, natural gas transmission and distribution, and telephone utilities, as well as water and wastewater companies.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGULATORY PROCEEDINGS ON UTILITY RATES?

A. Yes. I have previously presented testimony on more than 200 occasions before the Federal Energy Regulatory Commission and the public utility commissions of Arizona, California, Colorado, Delaware, the District of Columbia, Florida, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Maryland, Montana, Nevada, New Jersey, Ohio, Oklahoma, Pennsylvania, Utah, Virginia and West Virginia, as well as before this Commission. I have also filed rate case evidence by affidavit with the Connecticut Department of Public Utility Control.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. I am presenting testimony on behalf of the Division of Public Utilities and Carriers (the Division).

Q. HAVE YOU PREVIOUSLY TESTIFIED ON WATER UTILITY ISSUES BEFORE THIS COMMISSION?

A. Yes, I have been asked by the Division to address water utility issues on several occasions. I testified on revenue requirement, cost of service and/or rate design issues in <u>Newport Water Division</u>, Docket No. 2029 and 2985; <u>Providence Water Supply Board</u>, Docket Nos. 2022, 2048, 2304, 2961, and 3163 and 3446; <u>Kent County Water Authority</u>, Docket No. 2098, <u>Woonsocket Water Department</u>, Docket Nos. 2099 and 2904; <u>United Water Rhode Island, Inc.</u>, (formerly Wakefield Water Company), Docket Nos. 2006 and 2873; and <u>Pawtucket Water Supply Board</u>, Docket Nos. 3193 and 3378.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL SOCIETIES?

A. Yes. I am a member of the American Water Works Association (AWWA) and the Chesapeake Section of the AWWA. I am currently Vice Chairman of the AWWA's Rates and Charges Committee and serve on the AWWA Water Utility Council's Technical Advisory Group on Economics.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Exeter Associates was retained by the Division to assist it in the evaluation of the rate filing submitted by the City of Newport Utilities Department, Water Division (Newport or the Water Division) on November 28, 2003. This testimony presents my findings and recommendations with regard to the overall revenue increase to which Newport is entitled. In addition, my testimony also addresses cost allocation and rate design issues.

Q. HAVE YOU PREPARED SCHEDULES TO ACCOMPANY YOUR TESTIMONY?

A. Yes. I have prepared Schedules TSC-1 through TSC-16. Schedule TSC-1 provides a summary of revenues and expenses under present and proposed rates. Schedules TSC-2 through TSC-16 present my adjustments to Newport's claimed revenues, operating expenses and debt service costs and other supporting information.

Q. WHAT TIME PERIODS HAVE YOU UTILIZED IN MAKING YOUR DETERMINATION OF NEWPORT'S REVENUE REQUIREMENTS?

A. Consistent with Newport's filing, I have utilized a test year ended March 31, 2003 and a rate year ending June 30, 2004 as the basis for determining the Water Division's revenue requirements and the rate increase necessary to recover those requirements.

Q. DO YOU HAVE ANY GENERAL COMMENTS WITH REGARD TO NEWPORT'S CLAIMED RATE YEAR COST OF SERVICE?

A. Yes. With the exception of a few line items, the operating expenses which Newport has included in its claimed rate year cost of service are simply the amounts included in the Water Division's budget for the fiscal year ending June 30, 2004 (FY 2004). As a result, the claimed expenses are not directly derived from or linked to the test year expenses in many cases. In reviewing the budgeted rate year expenses, I have identified a significant number of line items where I have questions about the budget estimate. However, most of these line items are relatively minor expenses. In developing my recommendation on behalf of the Division, I have focused on those budgeted costs where the amount of the costs in question are significant.

Q. DID NEWPORT SUBMIT AN INCOME STATEMENT AS PART OF ITS FILING SHOWING REVENUES AT PRESENT RATES, RATE YEAR EXPENSES AND ITS CALCULATED REVENUE DEFICIENCY?

A. No. In its filing, Newport failed to provide an income statement or other summary which compares revenue at present rates to its claimed expenses in order to identify the increase in revenue which it is seeking.

Q. HAVE YOU PREPARED SUCH A COMPARISON?

A. Yes. Schedule TSC-1 presents a comparison of revenues and expenses at present and proposed rates beginning with the Company's filed claim and recognizing the Division's adjustments. As shown in the column "Rate Year Amount per Newport," Newport's filing recognizes revenues at present rates of $7,729,689 and a total cost of service of $8,334,351. This schedule indicates that Newport has claimed a revenue deficiency at present rates of $606,662.

Q. WHAT IS THE AMOUNT OF THE INCREASE IN REVENUES WHICH YOU ARE RECOMMENDING?

A. As shown on Schedule TSC-1, it is my recommendation that Newport not receive any increase in revenues in this proceeding. Although operations and maintenance (O&M) expenses have increased since the Water Division's last rate case, the Water Division did not spend the monies which the Commission provided in rates for debt service and cash capital outlays. As a result, significant balances have built up in the debt service and capital improvements restricted accounts which can be drawn down over the next several years to help meet debt service requirements and help pay for capital improvements. As a result, no increase in revenues is required.

In this regard and as discussed in more detail subsequently in my testimony, my recommendation would have been for a reduction in revenues based on the allowance for funding the debt service and capital spending restricted accounts proposed by the Water Division in its filing. However, rather than reducing rates and revenues now only to have to increase them by even more in the future to meet capital funding or other needs, I have proposed to increase the amount contributed to the restricted capital spending account. I have increased the annual contribution to the restricted capital spending account over the level proposed by Newport by the amount necessary to match existing revenue levels.

Q. HOW WOULD CHANGES TO YOUR RECOMMENDED ADJUSTMENTS AFFECT YOUR FINDING THAT NEWPORT SHOULD NOT RECEIVE AN INCREASE IN REVENUES IN THIS PROCEEDING?

A. As shown on Schedule TSC-1, I have proposed that the amount contributed to the capital outlay restricted account be increased by $462,623 to avoid reducing rates. Therefore any increases in Newport's costs over my recommendations which the Commission determines to be appropriate would not affect the allowable revenue increase until the amount of those adjustments exceeds $462,623. In other words, any increases in Newport's other costs would simply reduce the excess available to contribute to the restricted account to avoid reducing rates. To the extent that the Commission found additional reductions to Newport's costs beyond those which I have recommended to be appropriate, the effect would be to increase the contribution to the restricted accounts if the Commission agrees that rates should not be reduced.

Fire Service Revenues

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO FIRE SERVICE REVENUES.

A. In its filing, Newport calculated the fire service revenues at present rates based on the number of public hydrants and private fire services as of March 30, 2002. This is not consistent with the level of revenues which will be generated from fire protection service during the rate year. Accordingly, I have adjusted fire service revenues at present rates to reflect the number of private fire services as of December 31, 2003, and the number of public hydrants as of January 2004.

The calculation of my adjustment is presented on Schedule TSC-3. As shown there, total fire service reviews at present rates are $765,610 based on private services as of December 31, 2003 and the number of public fire hydrants as of January 2004. This represents an increase of $21,995 compared to the fire service revenues recognized by the Water Division in its filing.

Q. WHY DID YOU UTILIZE THE NUMBER OF PUBLIC FIRE HYDRANTS AS OF JANUARY 2004?

A. I utilized the number of hydrants in January 2004 rather than at December 31, 2003 because Newport officially activated and began billing 16 new hydrants in January when final inspection notifications were received. (This was the first time new hydrants were placed in service since sometime during the 12 months ended June 30, 2002.) Accordingly, the number of hydrants as of January 2004 is more reflective of the ongoing levels of service being provided and the revenues which will be generated.

Miscellaneous Revenue

Q. WHAT ADJUSTMENTS HAVE YOU MADE TO THE MISCELLANEOUS REVENUE RECOGNIZED BY THE WATER DIVISION?

A. I have made two adjustments to the miscellaneous revenues recognized by Newport in its filing. First, Newport identified projected Customer Service Revenues of $85,000 for the rate year.[1] However, in totaling the miscellaneous revenues available as an offset to the costs which must be recovered from water and fire service, Newport failed to include these revenues. Accordingly, I have increased miscellaneous revenue by $85,000 to include Customer Service Revenue.

Second, I have adjusted interest income to be consistent with actual experience during the rate year to date. As can be expected, there are variations between actual revenues and the projected revenues based on six months of experience for all of the components of miscellaneous revenue. However, these variations are relatively minor for all of the component accounts with the exception of interest income. Actual interest income for the first six months of the rate year was $19,002 compared to Newport's total rate year estimate of $20,000. Based on the actual interest income for six months, I have adjusted rate year interest income to reflect a total of $38,000.

Q. HAVE YOU PREPARED A SCHEDULE SUMMARIZING THE TOTAL EFFECT OF YOUR ADJUSTMENTS TO MISCELLANEOUS REVENUE?

A. Yes. As shown on Schedule TSC-4, the effect of my adjustments is to increase interest income by $18,000 and Customer Service Revenue by $85,000. This results in a total increase in miscellaneous revenue of $103,000.

[1] Customer Service Revenues are derived from charges for non-recurring activities such as billing for new meters, tapping fees, seasonal activation and termination of water service, etc.

Benefits Expense

Q. PLEASE EXPLAIN WHAT CLAIM NEWPORT MADE FOR EMPLOYEE BENEFITS EXPENSE?

A. Newport based its claims for benefits expense on its FY 2004 budget, in which benefits for current employees and retirees are separate line items. In addition to medical, dental, and life insurance premiums, line item 100-Employee Benefits includes retirement plan contributions and FICA taxes. Newport's budgeted expense for this line item reflects a 25.8 percent increase over the last year. For line item 103-Retiree Benefits, Newport reflected a 14.3 percent increase. In addition, there is a separate line item 105 for Workers Compensation costs. The amount included for this line item is based on the Water Fund's share of an estimate provided by the Rhode Island Interlocal Trust (The Trust), which provides worker's compensation insurance.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO NEWPORT'S CLAIM?

A. I am proposing to adjust Newport's claim for benefits expense to reflect actual experience during the rate year for both employee and retiree benefits. Because new premium and contribution rates are effective on a fiscal year basis, costs incurred since July 1, 2003 are reflective of the current rates. Accordingly, I have calculated my recommended allowance by annualizing costs for the first seven months of FY 2004. As shown on Schedule TSC-5, annualized costs based on actual experience for July 2003 through January 2004 are $96,178 less than Newport's rate year claim.

In calculating my recommended allowance for benefits expenses on Schedule TSC-5, I have recognized that the premium level for worker's compensation insurance turned out to be higher than originally estimated. Newport has indicated in response to Division Data Request Set III, item 2 (DIV 3-2) that it will only be required to pay the original estimate of $36,400 assigned to it by the City in FY 2004. However, I have reflected the higher premium to more accurately reflect ongoing costs.

Rate Case Expense

Q. PLEASE SUMMARIZE THE WATER DIVISION'S CLAIM FOR RATE CASE EXPENSES?

A. Newport has included $200,000 in its claimed cost of service for rate case expense. This represents the Water Division's estimate of the costs of its consultants and attorney for this proceeding. Newport is proposing to include the full amount of these estimated costs as an annual expense.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THIS CLAIM?

A. Rather than treating rate case expenses as an annual expense, I am proposing that the costs be normalized over two years. In addition, I am recommending that, consistent with Commission practice, rate case expenses be adjusted at the end of this proceeding to reflect actual costs, including those incurred by the Division.

As shown on Schedule TSC-6, I have reduced Newport's claimed cost of service by $100,000 to reflect recovery of its original estimate of costs over two years. This adjustment should be revised later when the actual costs of this proceeding become known. I would note that Newport's estimate of $200,000 as its costs of this proceeding seems quite high for a municipal utility and, hopefully, will be sufficient to account for the Division's costs and other incidental costs, such as transcripts.

Regulatory Reporting Expense

Q. PLEASE SUMMARIZE NEWPORT'S CLAIM RELATED TO REGULATORY REPORTING EXPENSE.

A. As part of its budgeted rate year expense claim, Newport included $20,000 in a new Administration line item No. 282-Regulatory Expense to cover the costs of an annual Consumer Confidence Report and other required regulatory reporting.[2] In doing so, Newport has treated these costs as though they are a new obligation which is not reflected elsewhere in its expenses.

Q. DO YOU AGREE WITH NEWPORT'S PROCEDURE FOR RECOGNIZING REGULATORY REPORTING COSTS?

A. No. During the test year, Newport incurred nearly $22,000 for regulatory reports including its consumer confidence report and two public notices regarding two separate drinking water violations. These costs were all included in Customer Accounts line items 225-Support Services and 238-Postage and Delivery. While the Water Division made a net downward adjustment to Postage and Delivery costs in moving from test year to rate year expense levels, no adjustment was made to Support Services expense to remove the costs of these reports. As a result, regulatory reporting costs have been overstated in Newport's rate year expense claim.

Q. HAVE YOU PREPARED A SCHEDULE WHICH DEVELOPS THE ADJUSTMENT NECESSARY TO ELIMINATE THIS OVERSTATEMENT?

A. Yes. My adjustment to eliminate the overstatement of regulatory reporting costs is presented on Schedule TSC-7. As shown there, I first determined the total amount included in the test year for regulatory reporting of $21,981. To this amount, I added

---

[2] Newport also included $85,000 in this line item for a Vulnerability Assessment which is addressed subsequently in my testimony.

$13,349, which is the net effect of the normalization and rate year adjustments which Newport made to the line items in which regulatory reporting costs are included in deriving its claimed rate year expense. Totaling these two figures reveals that $35,330 was included in Newport's filed claims for regulatory reporting costs. Finally, I compared this total to the $20,000 which Newport has identified as the required allowance for regulatory reporting costs. This results in a downward adjustment of $15,330 to rate year expenses to eliminate the overstatement of regulatory reporting costs.

Q. OTHER THAN INCLUDING $20,000 IN THE NEW LINE ITEM 282, WHAT OTHER ADJUSTMENTS DID NEWPORT MAKE TO TEST YEAR REGULATORY REPORTING COSTS?

A. Other than including $20,000 in the new line item 282-Regulatory Expense, the other significant adjustment made by Newport was to reduce Postage and Handling by a net amount of $6,794. This was done as part of an adjustment to transfer all non-billing related costs from Customer Accounts to Administration. To be conservative, I have treated this entire net reduction as a reduction to regulatory reporting costs. Newport also made a rounding adjustment to increase Support Services by $143.

In her direct testimony (at page 11), Ms. Forgue identifies line item 430-Capital Studies as being the predecessor for the new line item 282. I have not considered this line item in my adjustment because none of the regulatory reporting costs were included in line item 430-Capital Studies during the test year. This line item, which totaled only $1,685 during the test year, is more closely associated with studies such as the Vulnerability Assessment which Newport also included in line item 282-Regulatory Expense.

Electricity Costs

Q. HOW DID NEWPORT DEVELOP THE BUDGETED LEVEL OF ELECTRICITY COSTS FOR FY 2004 THAT IT INCLUDED IN ITS CLAIMED COST OF SERVICE?

A. According to the response to DIV 1-20, Newport relied primarily on the most recent complete fiscal year for which it had data (FY 2002) as the basis for its FY 2004 budget. It then adjusted these amounts to take into consideration expected changes and historical expenditures. That response notes, for example, that electricity costs for the Sakonnet and Paradise Pump Stations (Source of Supply-Mainland) were reduced from FY 2002 levels because usage of those stations was above average in 2002. Similarly, Lawton Valley water treatment plant (WTP) electricity costs were increased from FY 2002 levels in anticipation of the proposed Residuals Management Pump Station becoming operational. (As discussed subsequently, this facility is not now scheduled to be in service before the end of 2005.)

Q. HOW DO NEWPORT’S RATE YEAR ELECTRICITY COSTS BASED ON ITS FY 2004 BUDGET COMPARE TO RECENT ACTUAL COSTS?

A. A comparison of Newport’s budgeted electricity costs for FY 2004 to those incurred in FY 2003 and in the most recent 12 months reveals that actual costs have been well below Newport’s budgeted rate year claim of $379,000. For FY 2003, actual electricity costs totaled $318,467 and for the 12 months ended January 2004, total electricity costs were $305,534.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THE RATE YEAR ALLOWANCE FOR ELECTRICITY EXPENSE?

A. I am proposing to adjust electricity expense to reflect the average annual costs based on the actual costs for the 24 months ended January 2004.[3] As shown on Schedule TSC-8, the average annual costs over this time period were $309,713. This represents a reduction to Newport's claimed rate year electricity costs based on its FY 2004 budget of $69,287.

Chemicals Expense

Q. WHAT HAS NEWPORT INCLUDED IN ITS RATE YEAR COST OF SERVICE FOR CHEMICALS EXPENSE?

A. Newport has based its claimed chemicals expense for the rate year on the amounts included in its FY 2004 budget. The total amount of chemicals expense which Newport has requested is $442,000, including $220,000 for the Newport WTP, $200,000 for the Lawton Valley WTP and $22,000 for Source of Supply-Island. These amounts reflect significant increases over the actual test year expenses, which Newport has attributed to the fact that test year expenses for the 12 months ending March 2003 were not typical of normal fiscal year expenses. (Responses to DIV 1-22 and 3-11.) In addition, Newport included $20,000 for incremental chemical costs at the Lawton Valley WTP in anticipation of new requirements to be identified in a pending Compliance Evaluation Study.

Q. WHAT CONCERN DO YOU HAVE WITH REGARD TO NEWPORT'S CLAIMED LEVEL OF CHEMICAL COSTS?

A. My analysis of Newport's claimed chemical costs indicates that the amounts claimed for the two treatment plants are substantially in excess of the required amounts based on the

[3] For Administration electricity costs, I have utilized the 12 months ended December 2003 because of an anomaly in the costs on March 2002 which would be picked up in the 24-month average. The amount recorded in March 2002 was approximately 5 times the monthly cost in any other month from July 2001 through January 2004.

actual chemical usage at these plants. In response to DIV 3-9 and DIV 3-11, Newport has indicated that actual chemical costs have been and will continue to be higher than the cost of chemicals used because chemicals must also be purchased for inventory. The need to purchase chemicals in one year to replenish inventory which was drawn down in a prior year could cause the cost of chemicals purchased to be up in one year after being down in a prior year. However, there should be no need to purchase additional chemicals year after year for inventory. Doing so would result in the build up of unnecessary inventory.

Q. HAVE YOU PREPARED AN ANALYSIS TO COMPARE CHEMICAL COSTS BASED ON ACTUAL CHEMICAL USAGE WITH NEWPORT'S CLAIM?

A. Yes. This analysis is shown on Schedule TSC-9. As indicated there, I have identified the quantities of each type of chemical used at each water treatment plant in FY 2002, FY 2003 and during the 12 months ending (TME) January 2004. For each chemical, I then identified the maximum quantity utilized in any of the three years and multiplied that quantity by the current price to calculate the maximum annual cost. Finally, I added the granulated activated carbon (GAC) cost at the Newport WTP and the $20,000 estimate for Compliance Evaluation related costs at the Lawton Valley WTP to derive total costs comparable to Newport's claim at each plant. As indicated on Schedule TSC-9, even when the maximum usage quantities in any of the three years are utilized to derive the annual cost, chemical expense for the Newport WTP is still more than $50,000 less than Newport's claim. Similarly, chemical expense for the Lawton Valley WTP is more than $43,000 less than Newport's claim.

Q. WHAT ALLOWANCE FOR CHEMICAL COSTS ARE YOU PROPOSING TO INCLUDE IN RATE YEAR EXPENSES?

A. I am proposing to set the allowance for chemical costs at the two water treatment plants based on the maximum usage quantities and current prices as shown on Schedule TSC-9. While this is conservative, I have used this procedure recognizing that Newport is required to maintain a restricted account for chemical costs. Accordingly, any differences between actual chemical usage and prices compared to those reflected in my estimate will be accounted for through the restricted fund.

I would note that an addition to the amounts shown on Schedule TSC-9, I have accepted Newport's $22,000 allowance for copper sulfate costs for the Island source of supply reservoirs. This brings the total chemical costs to be contributed to the restricted fund to $348,012. This is $93,988 less than Newport's claim. It also represents an increase of $55,826 over the current level of chemicals funding of $292,186 approved in Docket No. 2985.

Q. DO YOU HAVE ANY OTHER COMMENTS WITH REGARD TO YOUR PROPOSED ALLOWANCE FOR CHEMICAL COSTS?

A. Yes. As noted previously, I have included Newport's estimate of $20,000 for additional chemical costs resulting from the Compliance Evaluation Study. The final report from that study was to be completed by the end on February 2004 and costs should be updated to be consistent with the findings of that final report.

Sewer Use Charges

Q. PLEASE EXPLAIN THE ADJUSTMENT THAT YOU HAVE MADE TO NEWPORT'S CLAIMED ALLOWANCE FOR SEWER USER CHARGES.

A. Currently, sludge from the Newport Station 1 WTP is disposed of through discharge to the City of Newport sewer system and the Water Division pays the applicable sewer user charges for this service. In the future, sludge from the Lawton Valley WTP will also begin to be disposed of in the same manner. In anticipation of this, Newport included an annual expense allowance of $104,000 for sewer user charges applicable to the disposal of sludge from Lawton Valley.

At the present time, the Residuals Management Pump Station necessary to connect the Lawton Valley WTP to the Newport sewer system is still in the design and engineering phase. The disposal of sludge from that WTP to the sewer system is currently not expected to commence until at least the end of 2005. Accordingly, it is premature to include sewer user charges for the disposal of Lawton Valley sludge as a rate year expense. Therefore, I have adjusted Newport's claimed cost of service to remove these charges. As shown on Schedule TSC-10, this adjustment reduces rate year O&M expense by $104,000.

Conference and Training

Q. WHAT CLAIM DID NEWPORT MAKE FOR CONFERENCES AND TRAINING EXPENSE?

A. Newport has included $12,000 in rate year operating cost for the costs of conferences and training for its employees. This amount is based on its FY 2004 budget for these costs.

Q. HOW DOES THIS COMPARE TO ACTUAL EXPERIENCE?

A. In comparison, the actual amount spent for conferences and training was $3,501 in FY 2002, $3,208 in FY 2003 and $1,348 for the first seven months of FY 2004.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO NEWPORT'S CLAIMED EXPENSE?

A. I am proposing to adjust Conferences and Training expense to reflect actual experience based on the average costs incurred in FY 2002 and FY 2003. As shown on Schedule

TSC-11, the average amount spent in FY 2002 and FY 2003 was $3,355. This results in a reduction of $8,645 to Newport's claimed cost.

Telephone & Communications Expense

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO TELEPHONE AND COMMUNICATIONS EXPENSE.

A. According to the response to DIV 1-31, Newport has made changes to its telecommunications service and equipment providers. These new arrangements have resulted in a reduction in costs compared to the arrangements that were reflected in the FY 2004 budget and, thus, included in rate year expenses. Accordingly, I have adjusted the rate year cost of service to reflect the current level of Telephone and Communications Expense. As shown on Schedule TSC-12, this adjustment reduces rate year expenses by $6,743.

Capital Items Removed from O&M

Q. PLEASE EXPLAIN YOUR ADJUSTMENT TO REMOVE CERTAIN ITEMS FROM O&M EXPENSE AND TO TREAT THEM AS CAPITAL ITEMS.

A. As a part of its budgeted rate year O&M expenses, Newport has included several large expenditures which I am proposing to remove from O&M expense. These include:

- $50,000 for depth surveys for all of the Island reservoirs included in line item 220 – Consultant Fees.
- $85,000 for a Vulnerability Assessment, which as noted previously, is included in line item 282 – Regulatory Expense.
- $58,000 included in Distribution line item 275 – Repair and Maintenance to engage an engineer to plan and specify the scope of work to make repairs to the Reservoir road Tank.

I am proposing to treat all of these costs as properly charged to the Capital Outlay restricted account for several reasons. First, all of these studies are more in the nature of capital outlays than O&M expenses. Second, all of the costs are non-recurring or periodic and, therefore, should not be included in the cost of service as recurring annual expenses. Third, the amounts which Newport has included for these items are not known and certain and actual costs could differ significantly from Newport's estimates. Finally, in the case of the Vulnerability Assessment, low cost funding and/or grants may be available to help pay for the costs.

Q. WHAT IS THE EFFECT OF YOUR ADJUSTMENT ON NEWPORT'S CLAIMED COST OF SERVICE?

A. As shown on Schedule TSC-13, the total costs which I am proposing be removed from O&M expense is $193,000. Because the capital outlay restricted account is currently overfunded, additional restricted fund contributions to pay for these costs are not necessary. Accordingly, the net effect of this adjustment is to reduce Newport's claimed cost of service by $193,000.

Payment to City General Fund

Q. PLEASE SUMMARIZE NEWPORT'S REQUEST WITH REGARD TO PAYMENTS TO THE CITY'S GENERAL FUND.

A. The Water Division has requested approval to make payments to the City's General Fund totaling $2.5 million over the next five years. Newport claims these payments are necessary to compensate the City for the money which the City advanced to cover a shortfall in the Water Fund. The Water Division has stated this deficiency is due to revenue shortfalls and came to light when the monies needed to fund the restricted account balances required by the Commission in its June 2000 Order in Docket No. 2985 were fully set aside in December 2002.

Newport has proposed to make payments to the City of $500,000 per year for five years. One half of these payments would be included in the current cost of service as an increased contribution to the debt service restricted fund. The other half of the payments would be obtained by drawing down the balance in the restricted debt service account. Accordingly, the net increase in current revenues which Newport has sought in this proceeding to make these payments is $250,000.

Q. WHAT CONCERNS DO YOU HAVE WITH NEWPORT'S CLAIM OF A $2.5 MILLION REVENUE DEFICIENCY?

A. I have two significant concerns with regard to Newport's claim. First, Newport has not prepared any analysis of revenues and expenses since June 2000 showing the build-up of the claimed deficiency. As a result, there is no way to evaluate the accuracy of the claim or the causes of the deficiency. Second, if rates were not adequate to meet costs, Newport should have been aware of this long before December 2002 and should have filed for rate relief before 2003. Allowing Newport to recover this claimed deficiency effectively excuses the Water Division and the City for failing to properly monitor and manage the finances and rates of the Water Division.

Q. HAS NEWPORT RAISED ANY OTHER ARGUMENTS WHICH YOU WOULD LIKE TO ADDRESS?

A. Yes. In response to DIV 1-41, the Water Division argues that there would be no deficiency if it was not for the fact that the monies had to be transferred to the restricted debt service and capital outlay accounts even though the monies had not been spent. The response goes on to note that the deficiencies would disappear if the restricted accounts were released.

Of course, this argument ignores the fundamental reason for establishing restricted funds to begin with. That is, Newport and other water utilities have requested significant amounts of revenue to pay for infrastructure replacement costs, capital improvements projects and the debt service associated with bonds issued to finance some projects. To ensure that the monies are available and used for that purpose and that the capital projects are undertaken, restricted accounts have been established.

Q. HOW DID NEWPORT CALCULATE THE AMOUNT WHICH IT SET ASIDE IN ITS RESTRICTED FUNDS?

A. When Newport identified the need to fund the balances in December 2002, Newport went back and determined what amount should have been set aside beginning July 1, 2000. The amount set aside each year was based on the full annual contributions identified by the Commission in its orders in Docket No. 2985.

Q. DO YOU HAVE ANY COMMENTS WITH REGARD TO THIS CALCULATION?

A. In examining Newport's claim, one possible issue that I evaluated was whether one cause of the shortfall was that monies were set aside prior to the time the revenues were collected from customers due to billing and collection lag. However, the rates approved by the Commission in Docket No. 2985 went into effect on April 1, 2000. Since Newport did not begin funding the restricted accounts until July 1, 2000, this provided three months for the new rates to be in place and revenues to be collected. Accordingly, I concluded that billing and collection lag did not contribute to the claimed shortfall in revenues.

The other factor I evaluated is how revenues collected by Newport compared to the revenues authorized in Docket No. 2985. This comparison revealed that revenue collected has been less than that approved by the Commission in FY 2001 through FY 2003. The fact that Newport collected less revenue than was authorized means that, all else being equal, Newport would not have enough revenue to fund the restricted accounts.

Q. HAVE YOU ANALYZED WHAT PERCENTAGE OF THE REVENUES AUTHORIZED BY THE COMMISSION WERE COLLECTED BY NEWPORT?

A. Yes. As shown on Schedule TSC-14, I have identified the billed revenue per books in each of the fiscal years 2001 through 2003. From these amounts, I have deducted the increase or added the decrease in customer accounts receivable to determine the collected revenue in each year. I have then compared these amounts to the revenues authorized by the Commission in Docket No. 2985 to determine the percentage of authorized revenues collected in each year. As indicated on Schedule TSC-14, these percentages varied from 98.56 percent in FY 2001, to 91.38 percent in FY 2002, to 93.74 in FY 2003.

Q. WHAT ARE THE IMPLICATIONS OF RECOGNIZING THAT REVENUES WERE BELOW THE AUTHORIZED LEVEL IN FY 2001 THROUGH FY 2003 ON THE AMOUNT OF RESTRICTED ACCOUNT FUNDING?

A. To examine the effects on the restricted accounts, I adjusted the required funding for each of the fiscal years 2001 through 2003 to reflect the percentage of the authorized revenues collected in each year. For example, in FY 2001, the first full year the rates approved in Docket No. 2985 were in effect, revenues were 98.56 percent of the approved levels. Multiplying this percentage by the total restricted account funding requirement results in available funding of $4,331,904. This is $63,310 less than the full requirement. The calculation for each year is shown on Schedule TSC-14. As indicated there, when the contributions to the restricted accounts are adjusted to recognize the percentage of authorized revenues which are collected, the total effect is to reduce the required contributions for the fiscal years 2001 through 2003 by $717,343.

Q. WHAT IS YOUR RECOMMENDATION?

A. I do not agree that Newport has demonstrated that the City should be paid the $2.5 million it has requested. Accordingly, I am proposing to eliminate this repayment from Newport's claimed cost of service. As noted previously, $250,000 of the annual payment was included in the cost of service and the remaining $250,000 was treated as being paid by drawing down the balance in the restricted debt service account. Accordingly, this adjustment reduces the cost of service by $250,000 as shown on Schedule TSC-15.

While I have not accepted the repayment of the $2.5 million to the City, it would not be unreasonable to adjust the amount which has been placed in the restricted accounts to recognize the percentage by which actual revenues fell below authorized levels in FY 2001 through FY 2003. Accordingly, I am proposing that the $717,343 calculated on Schedule TSC-14 be released from the restricted accounts and returned to the City for those years. Rather than adjusting each restricted account, I would recommend that the full $717,343 be taken from the debt service account. This is consistent with Newport's restricted fund projections which utilized the balance in that account as the source of one-half of its $2.5 million proposed repayment to the City.

Restricted Account Contributions

Q. HOW DID NEWPORT ESTABLISH ITS PROPOSED LEVELS OF FUNDING FOR THE CAPITAL OUTLAY AND DEBT SERVICE RESTRICTED ACCOUNTS?

A. Newport established its proposed levels of funding the capital outlay and debt service restricted accounts at a level which would draw down the current excess balances over several years. These balances have built up because the Water Division has not undertaken the capital outlays and issued the debt for which it sought and received approval in Docket No. 2985.

Q. HOW DO THE RESTRICTED ACCOUNT CONTRIBUTIONS PROPOSED BY NEWPORT IN THIS CASE COMPARE TO THOSE APPROVED IN DOCKET NO. 2985.

A. Excluding the $250,000 which Newport included as a current contribution to be used to make the payment to the City General Fund, Newport has proposed a contribution to the debt service restricted account of $1,361,853. This compares to the allowance approved in Docket No. 2985 of $2,701,874. Newport's proposed contribution to the capital outlay restricted account is $904,167 compared to the $1,401,154 approved in Docket No. 2985. Overall, Newport's proposed contributions represent a reduction of $1,837,008 in the amount contributed to these two accounts. This reduction reflects that fact that Newport has not undertaken the capital outlays and issued the debt it identified as necessary approximately four years ago in Docket No. 2985. As a result, both restricted accounts have significant cash surpluses.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO MAKE TO THE ANNUAL AMOUNT CONTRIBUTED TO THESE RESTRICTED FUNDS?

A. The adjustments to Newport's claimed revenues and expenses that I have previously explained eliminate Newport's claimed revenue deficiency and produce a revenue surplus at present rates. However, it is possible that if rates are reduced now, they may have to be increased again in the near future to allow Newport to pay for its infrastructure replacement (IFR) program, its capital improvements program and any debt service on new bonds issued to fund those needs. Therefore, rather than recommending a rate reduction, I am proposing to increase the annual contributions to the restricted accounts by the amount necessary to match costs with revenues at present rates. As shown on Schedule TSC-1, I have calculated the total increase in the annual funding to be $462,623. I have included the full amount of this increase as a contribution to the capital outlays restricted account.

My recommendation to increase the contribution to the restricted capital outlays account reflects the concern that Newport will need additional funds to meet its capital needs as it undertakes the projects that is has delayed in the past as well as new work that is identified. By increasing the contributions to the restricted capital outlays account, the additional monies will be set aside and will be available to meet future capital needs. Newport is currently in the process of preparing the updated IFR program required by law every five years. Accordingly, the status of the restricted account balance relative to capital needs can be reevaluated in Newport's next rate case.

Restricted Account Analysis

Q. HAVE YOU PREPARED AN ANALYSIS OF THE DEBT SERVICE AND CAPITAL OUTLAYS RESTRICTED ACCOUNTS WHICH REFLECT THE CHANGES YOU HAVE PROPOSED?

A. Yes. Schedule TSC-16 presents an analysis of both of the debt service and capital outlays restricted accounts for FY 2004 through FY 2008. In preparing this analysis, I started with account balances and cash flows presented by Newport witness Harold J. Smith on Schedule RFC 12. I then included the changes which I have recommended in my testimony. These include.

- Charging the costs of depth surveys, Vulnerability Assessment and Reservoir Road Tank Repairs to the capital outlays account.
- Releasing $717,343 from the debt service account to recognize reduced funding requirements for FY 2001 through FY 2003 based on revenues collected versus authorized.
- Eliminating the $250,000 funding contribution from rates and $500,000 per year payment to the City General Fund from the debt service account.
- Increasing the annual funding contribution to the capital outlays account by $462,623, which is the amount necessary to match expenses with revenues at present rates.

As shown on Schedule TSC-16, the projected balance in the debt service restricted account after reflecting the above changes is $523,394 at the end of FY 2008. This compares to Newport's projected balance of $1,411. For the capital outlays account, the projected balance in FY 2008 with the changes I have recommended is $2,205,919. This compares to Newport's projected balance in FY 2008 of $24,661.

Cost Allocation

Q. PLEASE PROVIDE AN OVERVIEW OF THE COST ALLOCATION STUDY SUBMITTED BY NEWPORT IN THIS PROCEEDING.

A. Newport has submitted a detailed class cost of service study prepared utilizing the base-extra capacity method set forth in the AWWA's Manual M1, the fifth edition of which is entitled "Principles of Water Rates, Fees, and Charges." This manual is commonly referred to as the AWWA Water Rates Manual. In its study, Newport has first assigned costs to functions which include: Supply & Treatment; Transmission; Distribution; Meters & Services; Customer Costs; and Fire Protection. These costs were then classified as base, extra capacity, customer or fire service related and, in turn, allocated to customer classes which include: residential; commercial; governmental; Navy; Portsmouth Water and Fire District (PWFD); public fire service; and private fire service.

Q. WHAT IS YOUR RECOMMENDATION WITH REGARD TO THIS STUDY?

A. The base-extra capacity method is the most widely utilized cost allocation methodology and it has been accepted for other Rhode Island water utilities. Therefore, I believe it is reasonable for Newport to utilize this methodology. However, I have identified a number of changes which should be made to the specific cost functionalization and allocation procedures which were utilized in Newport's study.

Q. WHAT CHANGES ARE YOU PROPOSING TO MAKE TO THE PROCEDURES WHICH WERE USED IN NEWPORT'S STUDY TO ASSIGN COSTS TO COST FUNCTIONS?

A. I am proposing several changes to the procedures used to assign costs to functional categories in Newport's study. First, consistent with my adjustment to recognize Customer Services Revenue as a source of income, these revenues should be assigned as an offset to Meter & Services and Customer Costs in proportion to the overall costs assigned to each function.

Second, the breakdown of the footage of mains used to allocate most Transmission and Distribution maintenance and investment costs should be corrected to include all mains 16 inches and larger in diameter as transmission. In Newport's study, mains 20 inches and larger in diameter were inadvertently classified as Distribution. In response to DIV 2-4, Newport has agreed this correction is appropriate.

Third, the investment allocator used to assign debt service related costs to cost functions should be revised to include the net investment in Supply Mains, which Newport failed to include in its final allocator. The response to DIV 2-6 indicates that Newport agrees with this change.

Fourth, Newport developed its investment allocator using net plant investment as of June 30, 2001. While such data may not be available in this proceeding, current net investment data should be used. Moreover, when significant new investments are being added for which the capital outlays and debt service are being recovered in rates, consideration should be given to adjusting the net investment to recognize the new additions. This is especially important if the new investments alter the mix of net investment per books.

Fifth, all capital costs, including debt service, capital improvements and IFR costs should be allocated on the basis of net investment. In its study, Newport allocated: debt service on the basis of net investment; cash outlays for capital improvements on the basis of the specific nature of each capital outlay; and cash outlays for IFR projects on the basis of a composite IFR allocator that reflects the individual IFR projects in the rate year.

The allocation of all capital costs on the basis of net investment is necessary to maintain consistency from case to case and to avoid fluctuations in rates. The decision regarding which projects to finance with debt and which to fund as a cash outlay is largely discretionary. Altering which projects are designated as being financed with debt and which are financed with cash could significantly alter cost responsibility. Similarly, the nature of the projects to be undertaken can vary from case to case. For example, if the projects to be funded with cash are primarily source of supply and treatment in one case and transmission and distribution in the next rate case, this could result in significant changes in cost allocations and rates from case to case. By allocating all capital costs on the basis of investment, these costs are allocated in a fair and consistent manner and fluctuations in cost responsibility are avoided.

Q. DO YOU HAVE COMMENTS WITH REGARD TO THE INVESTMENT ALLOCATOR USED TO ALLOCATE IFR COSTS?

A. Yes. The Commission has previously found in a number of cases that IFR costs should not be allocated to fire protection or meter and service related costs because IFR costs are to be collected through commodity charges. Consistent with these prior decisions, fire service investment should be excluded from the calculation of the IFR allocator. In addition, Meter and Service related IFR costs should not be allocated to Newport's wholesale customer, PWFD. Therefore, rather then simply excluding Meter and Service related investment, this investment should be reassigned to the Transmission and Distribution functions on the basis of the investment in those two categories in developing the net investment allocator for IFR costs.

Q. WHAT CONCERN DO YOU HAVE WITH THE PROCEDURES USED TO ALLOCATE COSTS TO CUSTOMER CLASSES?

A. My primary concern pertains to the development of the peak day demand factors used to allocate extra-capacity related costs to customer classes. To develop those factors, Newport utilized a method explained in the AWWA Water Rates Manual which relies on having the average daily flow in the month in which each class has its maximum consumption. However, the vast majority of Newport's residential customers are billed on a tertiary (every 4 months) basis. Accordingly, Newport did not have maximum month data for the residential class and assumed that the maximum month consumption was equal to the average in the maximum four-month period. As a result, I believe that it is likely that the peak day demand of the residential class is understated relative to the other classes.

Q. WHAT IS YOUR RECOMMENDATION AS HOW TO RECALCULATE THE PEAK DAY DEMANDS?

A. Absent the availability of peak monthly demand data for all classes, one solution would be to calculate the peak demands for all classes on a consistent basis. That is, the peak day demand factor for all customer classes could be derived starting with the average daily demand of each class in the same four-month period (July-October) as was used for the residential class. However, I am not proposing that this be done because doing so will not significantly affect rates.

Q. PLEASE EXPLAIN.

A. Because of the nature of the Newport system and the manner in which costs have been classified, no maximum day extra capacity costs have been assigned to PWFD and very few have been assigned to the Navy. The primary costs allocated using the base and extra-capacity maximum day factors are distribution costs which are only allocated to retail customers. Moreover, Newport has proposed to implement a single commodity rate for all retail customers because cost based rates would not differ significantly between classes and because Newport cannot draw a clear distinction between the residential and commercial customer classes. As discussed subsequently, I am accepting Newport's proposal to establish a single retail commodity rate. Therefore, I am not proposing that Newport recalculate demand factors in this proceeding.

Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE ALLOCATION OF COSTS TO CUSTOMER CLASSES?

A. Yes. In its study, Newport did not allocate any Meter & Services or Customer Costs to fire service. In response to DIV 4-1, Newport indicated that this is because most of its Customer Services costs (80 percent) are related to meter maintenance and meter reading. Because fire service accounts are only billed annually and are not metered, Newport argues that the amount of billing costs would be negligible.

Despite these arguments, I am recommending that a portion of Meter & Services and Customer Costs be allocated to fire service based on the number of fire service bills relative to the actual number of water service bills. Although the overall amount of costs allocated to fire service may not be significant, the cost of billing fire services customers should be included as part of their rates. Recognizing 20 percent of total costs included in the Base (or Customer) Charge from Newport's Study as billing related indicates that the average cost for bill is over $3.00.[4]

Q. HAVE YOU PREPARED A REVISED COST ALLOCATION STUDY WHICH REFLECTS THE CHANGES THAT YOU HAVE PROPOSED TO NEWPORT'S CLASSIFICATION AND ALLOCATION OF COSTS AS WELL

[4] A significant portion of the Meters & Services costs included as part of the base charge are service line related and would be applicable to fire services. Hence, use of 20 percent of the overall costs is conservative.

AS YOUR ADJUSTMENTS TO NEWPORT'S CLAIMED REVENUE REQUIREMENTS?

A. No. Due to the structure and complicated manner in which Newport's cost allocation model was developed, it was not possible for me to rerun the model with my recommended changes without devoting substantial time and effort. In light of my recommendation that Newport receive no rate increase, it was concluded that it would not be an efficient use of Division resources to devote that time and effort, the costs of which would ultimately borne by Newport's ratepayers.

Rate Design

Q. PLEASE EXPLAIN YOUR RATE DESIGN RECOMMENDATIONS.

A. Based on my recommendation that Newport not receive a revenue increase in this proceeding, I am recommending that the Water Division's existing rates remain unchanged, with the exception of the commodity rates for retail water service. Although, as explained previously, I have not prepared a revised study, it would not appear that any of the existing rates depart significantly from cost. In addition, Newport did not propose any change in fire protection rates other than to add new rates for 5/8-inch and 2-inch fire services.

With regard to retail commodity rates, Newport has been transitioning toward uniform rates and the Water Division was directed to file flat retail commodity rates in Docket No. 2985. As noted previously, commodity costs do not differ significantly by customer class and Newport cannot readily distinguish customer classes. Accordingly, establishing a single commodity rate applicable to all retail consumption is appropriate. Based on Newport's projected rate year retail consumption revenues at present rates of

$4,713, 347 and sales of 1,392,619.5 thousand gallons, the uniform retail commodity rate would be $3.38 per thousand gallons.

Q. DO YOU HAVE ANY COMMENTS REGARDING NEWPORT'S PROPOSED METHOD OF CALCULATING THE CUSTOMER OR BASE CHARGE FOR RETAIL SERVICE?

A. Yes. Currently, the customer charge or base charge for retail water service is $11.00 per bill, independent of whether the customer is billed monthly or three times per year. Newport has proposed that this customer charge be calculated so that a customer which is billed three times a year will be charged a rate four times the rate applicable to monthly customers. By doing so, Newport is proposing that all customers pay the same amount per year regardless of the frequency of billing.

The majority of the costs included in the customer charge are associated with meter reading and billing and these costs vary directly with the frequency of billing. In addition, those costs which do not vary with billing frequency, meter and service maintenance costs, vary with meter and service size. Although, Newport does not track meter and service diameter for billing purposes, it is logical that the commercial customers who are primarily billed monthly have larger meters and services on average than residential customers who are primarily billed three times a year. Therefore, I am recommending that customer charge remain the same per bill, independent of the frequency of billing.

Q. IS THERE ANY OTHER RATE DESIGN PROPOSAL WHICH YOU WOULD LIKE TO ADDRESS?

A. Yes. Newport has proposed to establish tariff rates for 5/8-inch and 2-inch diameter private fire services in order to have rates on file should the demand for such service arise. I agree that this is appropriate and would recommend that a rate for 3/4 and 1-inch fire service lines also be established.

Newport proposed a rate of $32.04 per year for 2-inch fire services. This is consistent with the existing rate for 6-inch fire services and the relative demand ratios for the two-service sizes. Accordingly, I believe this rate is acceptable, but would propose that it be rounded to $32.00 per year.

Newport calculated a rate of $5.28 per year for a 5/8-inch fire line based on a demand ratio of 1.0. Given that the demand ratio for a one-inch service line is 1.0, I would recommend that the same rate apply to fire services up to one-inch. Since billing costs were not included, and in order to avoid a fire service rate less than the retail customer charge, I would recommend that a rate of no less than $11.00 per year be established for one-inch and smaller fire services.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, it does.

W:\2986\tsc\dirtest\Direct.doc

BEFORE THE

PUBLIC UTILITIES COMMISSION

OF RHODE ISLAND

CITY OF NEWPORT	**)**	
UTILITIES DEPARTMENT,	**)**	**DOCKET NO. 3578**
WATER DIVISION	**)**	

SCHEDULES ACCOMPANYING THE

DIRECT TESTIMONY

OF

THOMAS S. CATLIN

ON BEHALF OF THE

DIVISION OF PUBLIC UTILITIES AND CARRIERS

MARCH 2004

EXETER

ASSOCIATES, INC.
5565 Sterrett Place
Suite 310
Columbia, Maryland 20904

Docket No. 3578
Schedule TSC-1

CITY OF NEWPORT--WATER DIVISION

Summary of Revenues and Expenses at
Present and Proposed Rates
Rate Year Ended June 30, 2004

	Rate Year Amount Per Newport	Division Adjustments	Rate Year at Present Rates	Allowable Revenue Increase	Rate Year at Proposed Rates
Revenue					
Customer Charge	$ 556,555	$ -	$ 556,555		$ 556,555
Retail Consumption	4,713,347	-	4,713,347		4,713,347
Wholesale/Bulk Sales	1,553,072	-	1,553,072		1,553,072
Fire Protection	743,615	21,995	765,610		765,610
Miscellaneous	161,100	103,000	264,100		264,100
Total Revenue	$ 7,727,689	$ 124,995	$ 7,852,684	$ -	$ 7,852,684
Expenses					
Water Administration	1,344,098	(207,861)	1,136,237	-	1,136,237
Customer Accounts	486,645	(19,652)	466,993	-	466,993
Source of Supply-Island	448,015	(70,495)	377,520	-	377,520
Source of Supply-Mainland	79,500	(14,544)	64,956	-	64,956
Treatment & Pumping-Newport Plant	1,214,365	(86,844)	1,127,521	-	1,127,521
Treatment & Pumping-Lawton Valley	1,097,580	(202,550)	895,030	-	895,030
Water Laboratory	199,347	(2,032)	197,315	-	197,315
Transmission & Distribution Maintenance	811,613	(83,193)	728,420	-	728,420
Fire Protection	14,000	-	14,000	-	14,000
Subtotal	$ 5,695,163	$ (687,172)	$ 5,007,991	$ -	$ 5,007,991
Payment to City General Fund	250,000	$ (250,000)	-	-	-
Debt Service	1,361,853		1,361,853	-	1,361,853
Capital Outlays	904,167	462,623	1,366,790	-	1,366,790
Total Expenses	$ 8,211,183	$ (474,549)	$ 7,736,634	$ -	$ 7,736,634
Operating Reserve	123,168	(7,118)	116,050	-	116,050
Total Cost of Service	$ 8,334,351	$ (481,667)	$ 7,852,684	$ -	$ 7,852,684
Revenue Surplus/(Deficiency)	($606,662)	$606,662	$0	$ -	$0

Docket No. 3578
Schedule TSC-2

CITY OF NEWPORT--WATER DIVISION

Summary of Division Adjustments to
Rate Year Revenues and Expenses at Present Rates
Rate Year Ending December 31, 2004

Description	Amount	Source
Fire Service Revenue	21,995	Schedule TSC-3
Miscellaneous Charges	103,000	Schedule TSC-4
Total Revenue Adjustments	124,995	
Benefits Expense	(96,178)	Schedule TSC-5
Rate Case Expense	(100,000)	Schedule TSC-6
Regulatory Reporting Expense	(15,330)	Schedule TSC-7
Electricity	(69,287)	Schedule TSC-8
Chemical Costs	(93,989)	Schedule TSC-9
Sewer Charges	(104,000)	Schedule TSC10
Conferences & Training Expense	(8,645)	Schedule TSC-11
Telephone & Communications	(6,743)	Schedule TSC-12
Costs to be Charged to Restricted Fund	(193,000)	Schedule TSC-13
Payment to City	(250,000)	Schedule TSC-15
Capital Outlay Restricted Funding	462,623	Schedule TSC-1
Operating Reserve	(7,118)	See Note (1)
Total Expense Adjustments	$ (481,667)	
Total Adjustment to Revenue Deficiency	(606,662)	

Note:

(1) Based on 1.5% of total expenses as reflected on Schedule TSC-1.

Docket No. 3578
Schedule TSC-3

CITY OF NEWPORT--WATER DIVISION

Adjustment to Fire Service Revenues to Reflect
Increase in Numbers of Services and Hydrants
Rate Year Ending June 30, 2004

	Number (1)	Current Rate	Annual Revenue
Private Fire Services			
5/8-Inch	-	$ -	$ -
2-Inch	-	-	-
4-Inch	43	285	12,255
6-Inch	229	570	130,530
8-Inch	58	1,305	75,690
10-Inch	1	2,155	2,155
12-Inch	1	3,460	3,460
Total	332		$ 224,090
Public Fire Hydrants	967	560	541,520
Total Fire Service Revenue			$ 765,610
Amount Per Newport (2)			743,615
Adjustment to Revenue			$ 21,995

Notes:
(1) Number of Private Fire Services as of December 31, 2003 and number of Public Fire Hydrants as of January 2004 per response to DIV 3-14.

(2) Rate year revenue per Schedule RFC-6.

CITY OF NEWPORT--WATER DIVISION

Adjuistment to Miscellaneous Revenue
Rate Year Ending June 30, 2004

Investment Interest Income		
Estimate Based on Actuals through 12/31/03 (1)	$	38,000
Amount per Filing (2)		20,000
Increase	$	18,000
Customer Services Revenue		
Estimated Revenue (2)	$	85,000
Amount per Filing (3)		-
Increase	$	85,000
Total Increase in Miscellaneous Revenue	$	103,000

Notes:

(1) Reflects $19,002 of interest income through 12/31/03 per response to DIV 2-3.

(2) Per Schedule RFC-2

(3) Per response to DIV 2-1, amount was inappropriately not recognized as a revenue offset in Newport's filing.

Docket No. 3578
Schedule TSC-5

CITY OF NEWPORT--WATER DIVISION

Adjustment to Budgeted Benefits Expense
To Reflect Actual Costs Incurred
Rate Year Ending June 30, 2004

	Benefits Expense per Filing (1)	Annualized Based on Actuals (2)	Adjustment
Administration	$ 46,475	$ 41,930	$ (4,545)
Administration-Retiree	153,758	140,415	(13,343)
Administration-Workers' Compensation (3)	36,400	39,377	2,977
Customer Service	108,472	104,150	(4,322)
Supply-Island	87,681	76,788	(10,893)
Supply-Mainland	2,000	173	(1,827)
Treatment-Newport	160,228	148,740	(11,488)
Treatment-Lawton Valley	159,353	132,430	(26,923)
Laboratory	37,739	35,707	(2,032)
Transmission & Distribution	# 145,099	121,317	(23,782)
Total Amount	$ 937,205	$ 841,027	$ (96,178)

Notes:

(1) Per Schedule RFC 1-A.

(2) Per response to DIV 3-15. Reflects costs for first 7 months of rate year annualized.

(3) Per response to DIV 3-2.

Docket No. 3578
Schedule TSC-6

CITY OF NEWPORT--WATER DIVISION

Adjustment to Rate Case Expense
Rate Year Ending June 30, 2004

	Total
Rate Case Expense per Filing (1)	$ 200,000
Amortization Period	2 Years
Annual Expense Allowance per Division (1)	$ 100,000
Annual Expense for Filing	$ 200,000
Adjustment to Expense	$ (100,000)

Note:
(1) Per response to DIV 1-16.

Docket No. 3578
Schedule TSC-7

CITY OF NEWPORT--WATER DIVISION

Adjustment to Regulatory Reporting Expense
Rate Year Ending June 30, 2004

		Amount
Regulatory Reporting Costs per books		
Consumer Confidence Report (1)	$	5,370
Turbidity Notice (2)		9,839
TOC Notice (2)		6,772
Total Test Year Expense	$	21,981
Normalization and Rate Year Adjustments (3)		
Postage		(6,794)
Support Services		143
Regulatory Reporting		20,000
Total Adjustments	$	13,349
Adjusted Expense included in Rate Year	$	35,330
Required Annual Amount (4)		20,000
Adjustment to Rate Year Expense	$	(15,330)

Notes:

(1) Per response to DIV 1-18.

(2) Per response to DIV 3-7.

(3) Adjusments reflected on Schedule RFC 1-A. Amount for postage reflects decrease in expense in Customer Accounts net of increase in Admistration for line item 238.

(4) Per testimony of Julia Forgue.

Docket No. 3578
Schedule TSC-8

CITY OF NEWPORT--WATER DIVISION

Adjustment to Budgeted Electricity Expense
To Reflect Actual Expense
Rate Year Ending June 30, 2004

	Budgeted Expense per Filing (1)	Annual Based on Last 24 Months (2)	Adjustment
Administration	$ 4,000	$ 3,905	$ (95)
Supply-Island	16,000	6,398	(9,602)
Supply-Mainland	50,000	37,283	(12,717)
Treatment-Newport	185,000	162,115	(22,885)
Treatment-Lawton Valley	115,000	89,566	(25,434)
Transmission & Distribution	# 9,000	10,446	1,446
Total Amount	$ 379,000	$ 309,713	$ (69,287)

Notes:

(1) Per Schedule RFC 1-A.

(2) Per responses to DIV 1-20 and 3-8. Amounts based on costs for 24 months ended January 2004 except Administration amount is for 2 months ended January 2004 due to anomoly in cost for March 2002.

Docket No. 3578
Schedule TSC-9

CITY OF NEWPORT--WATER DIVISION

Analysis of Average Annual Chemical Costs
at the Newport and Lawton Valley Water Treatment Plants
Rate Year Ended June 30, 2004

Chemical	FY 2002 Usage in Pounds	FY 2003 Usage in Pounds	TME 1/04 Usage in Pounds	Maximum Annual Usage	Current Cost Per Pound	Annual Cost
	(1)	(2)	(3)	(4)	(5)	(6)
Newport Water Treatment Plant						
Alum	311,999	328,912	340,433	340,433	$ 0.1079	36,724
Lime	184,043	166,541	179,408	184,043	0.0644	11,852
Chlorine	56,750	51,880	49,040	56,750	0.2450	13,904
Flouride	15,291	13,843	17,894	17,894	0.3000	5,368
Sodium Chlorite	77,556	93,334	77,982	93,334	0.5270	49,187
Polymer	1,000	1,300	1,250	1,300	4.8700	6,331
Subtotal						$ 123,367
Granular Activated Carbon						45,830
Annual Cost Based on Maximum Usage						$ 169,197
Amount per Newport Filing (2)						$ 220,000
Adjustment to Chemicals Expense						$ (50,803)
Lawton Valley Water Treatment Plant						
Alum	476,483	498,285	400,042	498,285	$ 0.1079	53,752
Lime	233,900	235,000	197,050	235,000	0.0785	18,445
Chlorine	39,640	37,027	33,304	39,640	0.2450	9,712
Flouride	15,526	12,766	15,954	15,954	0.3000	4,786
Sodium Chlorite	95,103	80,219	71,277	95,103	0.5270	50,119
Annual Cost Based on Maximum Usage						$ 136,815
Allowance for Additional Needs from Compliance Evaluation Study						20,000
Adjusted Annual Costs						$ 156,815
Amount per Newport Filing (2)						$ 200,000
Adjustment to Chemicals Expense						$ (43,185)

Notes:
(1) All quantities and prices are per the response to DIV 3-9.

(2) Per Schedule RFC 1-A.

Docket No. 3578
Schedule TSC-10

CITY OF NEWPORT--WATER DIVISION

Adjustment to Newport Sewer Charges
Rate Year Ending June 30, 2004

	Total
Lawton Valley Sewer Charges per Filing (1)	$ 104,000
Rate Year Amount per Division (2)	-
Adjustment to Expense	$ (104,000)

Notes:
(1) Per Schedule RFC 1-A.

(2) Recognizes that Lawton Valley is not anticipated to begin discharging waste to Newport sewer system before December 2005.

CITY OF NEWPORT--WATER DIVISION

Adjustment to Reflect Average
Conferences & Training Expense
Rate Year Ending June 30, 2004

	Amount per Filing (1)	FY 2002 and 2003 Average (2)	Adjustment
Administration	$ 2,000	$ 888	$ (1,112)
Treatment-Newport	2,500	833	(1,668)
Treatment-Lawton Valley	3,500	492	(3,009)
Transmission & Distribution	# 4,000	1,143	(2,857)
Total Amount	$ 12,000	$ 3,355	$ (8,645)

Notes:
(1) Per Schedule RFC 1-A.

(2) Per response to DIV 1-26.

Docket No. 3578
Schedule TSC-12

CITY OF NEWPORT--WATER DIVISION

Adjustment to Telephone & Communications Expense
Rate Year Ending June 30, 2004

Telephone & Communications Expense per Filing (1)	$	15,000
Annualized Expense based on Current Services (2)	$	8,257
Adjustment to Rate Year Cost of Service	$	(6,743)

Notes:
(1) Per Schedule RFC 1-A.

(2) Per response to DIV 1-31.

Docket No. 3578
Schedule TSC-13

CITY OF NEWPORT--WATER DIVISION

Adjustment to O&M Expense to Remove Capital Items
Rate Year Ending June 30, 2004

Description	Amount
Depth Surveys	$ 50,000
Vulnerability Assessment	85,000
Reservoir Road Tank Repairs	58,000
Total to be Paid from Restricted Fund	$ 193,000
Amount to be Included as O&M	$ -
Adjustment to Rate Year O&M Expense	$ (193,000)

Notes:
(1) Per response to DIV 1-15.

(2) Per response to DIV 1-17.

(3) Per response to DIV 1-27.

Docket No. 3578
Schedule TSC-14

CITY OF NEWPORT--WATER DIVISION

Analysis of Revenues and
Restricted Account Funding for FY 2001-FY 2003
Rate Year Ending June 30, 2004

	FY 2001	FY2002	FY 2003
Billed Revenue Per Books (1)	$ 7,644,448	$ 6,928,286	$ 7,464,619
Change in Customer Acounts Receivable (1)	96,649	(69,951)	286,211
Collected Revenue	$ 7,547,799	$ 6,998,237	$ 7,178,408
Authorized Revenue In Docket No. 2985	$ 7,658,108	$ 7,658,108	$ 7,658,108
Percent of Authorized Revenues Collected	98.56%	91.38%	93.74%
Restricted Funding Requirement (2)	$ 4,395,214	$ 4,395,214	$ 4,395,214
Amount Available Based on Percent Collected	4,331,904	4,016,495	4,119,900
Difference Between Requirement and Available	$ (63,310)	$ (378,719)	$ (275,314)
Total Difference FY 2001-FY2003			$ (717,343)

Notes:

(1) Per Annual Reports to the Commission.

(2) Based on following amounts from Docket No. 2985:

Chemicals	$ 292,186
Debt Service	2,701,874
Capital Outlays	1,401,154
Total	$ 4,395,214

CITY OF NEWPORT--WATER DIVISION

Adjustment to Eliminate Repayment to City
Rate Year Ending June 30, 2004

	Total
Repayment Included as Current Expense (1)	$ 250,000
Rate Year Amount per Division	-
Adjustment to Expense	$ (250,000)

Note:
(1) Per Schedule RFC 12.

CITY OF NEWPORT--WATER DIVISION

Analysis of Restricted Account Balances for FY 2004-FY 2008
Based on Proposed Funding and Current Cost Estimates
Rate Year Ending June 30, 2004

	Fiscal Year Ending June 30				
	2004	**2005**	**2006**	**2007**	**2008**
Debt Service Account					
Beginning Cash Balance	$ 1,975,973	$ 927,111	$ 750,075	$ 618,728	$ 542,685
Additions					
Debt Service Funding Contribution	$ 1,361,853	$ 1,361,853	$ 1,361,853	$ 1,361,853	$ 1,361,853
Interest Income	30,141	29,031	16,772	13,688	11,614
Total Additions	$ 1,391,994	$ 1,390,884	$ 1,378,625	$ 1,375,541	$ 1,373,467
Deductions					
Existing Debt Service	1,723,513	1,290,002	1,232,054	1,173,667	1,114,840
SRF Loan Principal	-	133,093	133,093	133,093	133,093
SRF Loan Interest	-	144,825	144,825	144,825	144,825
Return Excess Contributions FY 2001-2003	717,343	-	-	-	-
Total Deductions	2,440,856	1,567,920	1,509,972	1,451,585	1,392,758
Ending Cash Balance	$ 927,111	$ 750,075	$ 618,728	$ 542,685	$ 523,394
Capital Spending Account					
Beginning Cash Balance	$ 2,473,692	$ 1,531,230	$ 1,265,655	$ 1,210,414	$ 1,705,965
Additions					
Capital Outlays Funding Contribution	$ 1,366,790	$ 1,366,790	$ 1,366,790	$ 1,366,790	$ 1,366,790
Interest income	41,333	40,049	27,969	24,761	29,164
Total Additions	$ 1,408,123	$ 1,406,840	$ 1,394,759	$ 1,391,551	$ 1,395,954
Deductions					
Captital Outlays per Newport Filing	2,157,586	1,672,414	1,450,000	896,000	896,000
Capital Items Removed from O&M	193,000	-	-	-	-
Total Deductions	2,350,586	1,672,414	1,450,000	896,000	896,000
Ending Cash Balance	$ 1,531,230	$ 1,265,655	$ 1,210,414	$ 1,705,965	$ 2,205,919